



October 27, 2006

Mr. Floyd Shimomura, Executive Officer  
State Personnel Board  
801 Capitol Mall  
Sacramento, CA 95814

Dear Mr. Shimomura:

**Final Report: State Personnel Board—Internal Control Review**

Enclosed is the final report on the State Personnel Board's (Board) internal control as of May 11, 2006. The Department of Finance, Office of State Audits and Evaluations (Finance), performed this review in accordance with the Financial Integrity and State Manager's Accountability Act of 1983, Government Code Section 13400 et seq.

The Board's response is included herein. Implementation of corrective actions will help strengthen the Board's internal control and reduce the risk of errors or irregularities.

The final report will be placed on the Finance website in accordance with Finance's policy of increased transparency. Finance appreciates the assistance and cooperation of staff and management during the review. If you have any questions, please contact Susan M. Botkin, Manager, or Brandon Nunes, Supervisor, at (916) 322-2985.

Sincerely,

Original signed by:

Diana L. Ducay, Chief  
Office of State Audits and Evaluations

Enclosure

cc: Ms. Laura M. Aguilera, Assistant Executive Officer, State Personnel Board  
Ms. Mary Fernandez, Division Chief, Administrative Services, State Personnel Board  
Ms. Lori Gillihan, Chief, Financial, Business, and Facility Management, State Personnel Board

# AN INTERNAL CONTROL REVIEW

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## STATE PERSONNEL BOARD

Prepared By:  
Office of State Audits and Evaluations  
Department of Finance

# TABLE OF CONTENTS

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Preface ..... iii

Executive Summary ..... v

Auditor’s Report ..... 1

Findings and Recommendations ..... 3

Conclusion ..... 12

Agency Response ..... 13

The State Personnel Board (Board) is responsible for the state's civil service system. The Board ensures that the civil service system is free from political patronage and that employment decisions are based on merit. The Board provides a variety of recruitment, selection, classification, appellate, goal setting, training, and consultation to state departments and local agencies.

State managers are required to maintain internal control in the programs they administer. Internal control is defined as a process designed to provide reasonable assurance regarding the achievement of objectives in the following categories: (a) reliability of financial reporting, (b) effectiveness and efficiency of operations, and (c) compliance with applicable laws and regulations. This definition of internal control includes five interrelated components:

- *Control environment* sets the tone of an organization, influencing the control consciousness of its staff. It is the foundation for all other components of internal control, providing discipline and structure.
- *Risk assessment* is the entity's identification and analysis of relevant risks to the achievement of its objectives, forming a basis for determining how the risks should be managed.
- *Control activities* are the policies and procedures that help ensure management directives are carried out.
- *Information and communication* are the identification, capture, and exchange of information in a form and time frame that enable people to carry out their responsibilities.
- *Monitoring* is the process that assesses the quality of internal control performance over time.

The objective of our internal control review was to assist the Board in complying with the Financial Integrity and State Manager's Accountability Act of 1983. Specifically, we assisted the Board in determining whether: (1) assets are safeguarded from unauthorized use or disposition, (2) financial transactions are executed in accordance with management's authorizations and recorded properly to permit the preparation of reliable financial statements, and (3) financial operations are conducted in accordance with State Administrative Manual guidelines, and certain other state laws and regulations, as well as the Board's policies and procedures.

Our review did not include an evaluation of the efficiency or effectiveness of the Board's operations, or the accomplishment of program goals or objectives.

This report is intended for the information and use of the Board and is not intended to be and should not be used by anyone other than the specified parties. However, this report is a matter of public record and its distribution is not limited.

**STAFF:**

Susan M. Botkin, CGFM  
Manager

Brandon Nunes  
Supervisor

Mike West, CPA  
Wendy Griffe  
Emmie Hoang  
Cindie Lor

## EXECUTIVE SUMMARY

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During our review of the State Personnel Board's (Board) internal control, we identified several areas where controls were in place and working as intended. We also identified areas where controls could be improved to reduce the risk of errors, irregularities, and material misstatements. We met with management and staff to discuss the following weaknesses, as well as other non-reportable findings and observations.

*Fixed Assets:* The internal control over property is insufficient to ensure proper safeguarding and reporting of the Board's fixed assets. Specifically, we found that:

- The Board does not maintain written policies and procedures over fixed assets.
- Fixed assets are not capitalized accurately.
- The property ledger is not maintained.
- A physical inventory is not performed.
- Adequate tagging of property does not exist.

*General Controls:* Several separation of duties concerns over information technology, cash receipts and disbursements, and purchasing were identified. Additionally, bank, revolving fund, and State Controller's Office reconciliations are not completed timely. Finally, approval was not obtained from the Department of Finance for the use of a fiscal agent or to maintain an account outside the centralized State Treasury System.

*Cash Receipts:* Controls over cash receipts need improvement to ensure the proper safeguarding of state assets. Specifically, not all cash receipts are deposited, endorsed, and recorded timely.

*Cash Disbursements:* Internal control over cash disbursements is sufficient to ensure that cash disbursements are made for allowable purposes and are accurately and promptly posted. However, our tests of controls indicated that unclaimed checks over one year are not cleared and the Accounting Officer does not review check requests and supporting documents prior to signing checks.

*Purchasing:* Internal control over purchasing needs improvement. Specifically, increased monitoring of open purchase orders needs to be implemented. Additionally, not all receiving documents are signed and dated by the receiver and not all invoices are adequately approved for payment.

*Revolving Fund:* The fund is not reimbursed timely, outstanding salary and travel advances are not collected timely, and revolving fund deficiency claims are not reported.

*Personnel/Payroll:* Internal control over personnel and payroll functions appear adequate to ensure the reliability and integrity of data. We observed the implementation and maintenance of current policies and procedures and adequate separation of duties among staff. However, our

tests of controls indicated that exit clearance forms for separating employees are not adequately completed.

*Contracts:* Internal control for contracts needs improvement to ensure that contract files include proper documentation.

For further information of the abovementioned weaknesses, see the *Findings and Recommendations* section of this report. This report is intended to assist the Board management in focusing attention on areas of risk, in strengthening internal control, and in improving operations.



## AUDITOR'S REPORT

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Mr. Floyd Shimomura  
Executive Officer  
State Personnel Board  
801 Capitol Mall  
Sacramento, CA 95814

We reviewed the State Personnel Board's (Board) internal control as of May 11, 2006, for conformity with Government Code Section 13400 et seq. Our review included obtaining an understanding of internal control through observations and interviews, identifying risks, testing and evaluating the design and operating effectiveness of the internal control, and performing other procedures we deemed necessary under the circumstances.

The Board's management is responsible for establishing and maintaining adequate internal control. This responsibility, in accordance with Government Code Section 13400 et seq., includes documenting internal control, communicating control requirements to employees, and ensuring that the internal control is functioning as prescribed. In fulfilling its responsibility, management is required to assess the expected benefits and costs of its control procedures.

The objectives of internal control are to provide reasonable, but not absolute, assurance that:

- Assets are safeguarded against loss from unauthorized use or disposition.
- Transactions are executed in accordance with management's authorization and recorded properly to permit the preparation of reliable financial statements.
- Financial operations are conducted in accordance with policies and procedures established in the State Administrative Manual, and certain other state laws and regulations, as well as the Board's policies and procedures.

Because of inherent limitations in internal control, misstatements due to error or fraud may occur and not be detected. Also, projection of any review of internal control to future periods is subject to the risk that the internal control may become inadequate because of changing conditions, or that the degree of compliance with policies or procedures may deteriorate.

In reviewing the Board's internal control as of May 11, 2006, we noted certain matters involving the internal control and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control that, in our judgment, could adversely affect the Board's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements. A material weakness is a condition that precludes the Board's internal control from providing reasonable assurance that material

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misstatements in the financial statements will be prevented, or detected on a timely basis. We believe the reportable condition concerning fixed assets is a material weakness. This weakness and other reportable conditions are described in the *Findings and Recommendations* section of this report.

This report is intended for the information and use of the Board and is not intended to be and should not be used by anyone other than the specified parties. However, this report is a matter of public record and its distribution is not limited.

Original signed by:

Diana L. Ducay, Chief  
Office of State Audits and Evaluations  
(916) 322-2985

May 11, 2006

## FINDINGS AND RECOMMENDATIONS

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We reviewed the accounting and administrative controls within the State Personnel Board (Board). During our review, we noted that a number of controls were functioning as intended. However, we also identified areas where controls are not in place and where corrective action is necessary, as described below.

### Fixed Assets

The combination of accurate accounting records and strong internal control must be in place to protect against and detect the unauthorized use of state property. The overall internal control over property is insufficient to ensure proper reporting of the Board's fixed assets. We identified the following material weaknesses.

#### **FINDING 1                      Inadequate Fixed Asset Controls**

Condition:                      The Board's current practices over fixed assets present a significant weakness in internal control. The following issues were identified:

- The Board does not maintain written policies and procedures over fixed assets. Consequently, staff has little guidance to assist them in appropriately accounting for state property.
- The Board does not capitalize fixed asset acquisitions. Since June 30, 1998, the Statement of General Fixed Assets has had a consistent balance of \$1,685,764 even though the Board has acquired and disposed of fixed assets.
- A Property Ledger is not maintained to identify all property owned by the Board. As a result, a reconciliation of the Property Ledger to the general ledger is not performed.
- Physical inventory counts have not been conducted for more than three years.
- Not all fixed assets are promptly and properly marked with a state identification tag. The Board only tags information technology items such as computers and monitors.

Criteria:                      State Administrative Manual (SAM) Chapter 8600 identifies adequate property accounting procedures required for proper fixed asset controls.

SAM Section 7924 requires that at least quarterly or monthly, agencies reconcile the acquisitions and disposals of capitalized property with the amounts recorded into the property ledger.

Recommendation:        Develop and implement fixed asset policies and procedures to ensure that state property is properly accounted for and adequately safeguarded from the risk of loss.

## **General Controls**

The combination of accurate accounting records and strong internal control must be in place to safeguard cash, establish accountability, ensure proper postings to the accounting records, and to prevent and timely detect errors or irregularities.

### **FINDING 2                      Separation of Duties**

Condition:                      The following separation of duties were identified as weaknesses in the Board's internal control:

#### ***Information Technology***

- All programmer analysts have the following incompatible duties:
  - Ability to create, read, update, and delete the Board's systems and data.
  - Ability to add and delete user rights to the system, as well as review and correct errors without any supervisor reviews.
- An Accounting Officer maintains CALSTARS table files, reviews table maintenance logs, performs daily batch reconciliations, reconciles subsystems to CALSTARS, and reviews error file corrections without any supervisor review.
- Daily batch reconciliations are not being reviewed by someone other than the preparer. Of the 14 reconciliations tested, none showed evidence of supervisor review.

#### ***Cash Receipts and Disbursements***

- An Accounting Officer performs the following incompatible duties:
  - Receives and deposits cash receipts.
  - Has access to the blank check stock.
  - Authorizes cash disbursements.
  - Prepares checks.
  - Distributes checks.
  - Signs checks.
  - Prepares the bank reconciliation and posts accounting transactions to the general ledger.
- A Business Services Assistant prepares invoices and receives cash receipts.

#### ***Purchasing***

- A Staff Services Analyst prepares and approves purchase orders, receives goods, prepares receiving reports, and approves invoices for payment.

Criteria: SAM Section 20050 states that a satisfactory system of internal accounting and administrative controls shall include a plan of organization that provides segregation of duties appropriate for proper safeguarding of state assets.

SAM Section 7908 states that all reconciliations will show the preparer's name, reviewer's name, date prepared, and date reviewed.

Recommendation: Ensure adequate separation of duties is implemented, and that daily batch reconciliations are properly reviewed.

### **FINDING 3                      Untimely and Unreviewed Reconciliations**

Condition: Bank reconciliations for the period July through December 2005 were prepared late; anywhere from 30 to 135 days. Additionally, the reconciliations showed no sign of supervisor review.

Further, the State Controller's Office (SCO)/CALSTARS reconciliations were not prepared monthly. Reconciliations for the period July 2005 through February 2006 were not completed until March 2006. Furthermore, the reconciliations did not show the preparer's signature and date, nor were they reviewed by someone other than the preparer.

Finally, revolving fund resources are not reconciled to the cash advance monthly.

Criteria: SAM Section 8060 states all bank accounts will be reconciled promptly at the end of each month.

SAM Section 7921 requires agencies to reconcile their accounts with the accounts maintained by the SCO. The SCO provides monthly Agency Reconciliation Reports to agencies in order to reconcile their account balances.

SAM Section 8193 states revolving fund resources will be reconciled with the amount of cash advanced.

SAM Section 7901 requires that all reconciliations will be prepared monthly within 30 days of the preceding month.

SAM Section 7908 states that all reconciliations will show the preparer's name, reviewer's name, date prepared, and date reviewed.

Recommendation: Prepare all reconciliations within 30 days of the preceding month, ensure a separate individual reviews reconciliations, and include the preparer's and the reviewer's signature and date on the reconciliation.

**FINDING 4                      Untimely Plans of Financial Adjustment**

Condition:                      Plans of Financial Adjustment (PFA) are not made on a monthly basis. No PFAs were prepared during fiscal year 2005-06 until April 2006.

Criteria:                        SAM Section 8452 states that transfers are to be made on a monthly basis.

Recommendation:          Complete PFAs on a monthly basis.

**FINDING 5                      No Approval of a Fiscal Agent and a Bank Account Outside the State Treasury System**

Condition:                      The Board has not requested approval from the Department of Finance, Fiscal Systems and Consulting Unit (FSCU) since 2001 for the use of a fiscal agent to collect fees for administering examinations and certifications for foreign language interpreters and to maintain an account outside the centralized State Treasury System.

Criteria:                        SAM Section 8002.1 requires requests for approval for the use of a fiscal agent to be submitted to FSCU. The fiscal agent shall maintain separate bank or savings and loan association accounts to account for any money under its control.

SAM Section 8002 requires requests for approval of bank, savings and loan association, or credit union accounts maintained outside the centralized State Treasury System to be sent to FSCU.

FSCU exemption approval letter dated October 27, 2000 stated the exemption was for the 2000-01 fiscal year only. Additionally, the Board was to submit a request for the use of a fiscal agent and for an account outside the centralized State Treasury System for contracts renewed after June 30, 2001.

Recommendation:          Request approval from FSCU for the use of a fiscal agent and to maintain an account outside the State Treasury System.

**Cash Receipts**

Effective internal control over cash receipts are necessary to safeguard cash, establish accountability, ensure timely deposits, ensure proper posting to the accounting records, and to prevent and timely detect any errors or irregularities. We identified the following weakness in the Board's internal control over cash receipts.

**FINDING 6                      Inadequate Controls Over Cash Receipts**

Condition:                      During our review, we noted the following weaknesses in the Board's cash receipt process:

- Not all cash receipts received are restrictively endorsed by the end of the working day. Specifically, the Bilingual Services

Unit (BSU) retains checks received for exam services until the day the exam is scheduled. As a result, the checks are not immediately forwarded to accounting for endorsement. Additionally, the Appeals Division and Technical Training Unit retain cash receipts for up to four days before they are forwarded to accounting for endorsement.

- Cash receipts retained by the BSU are not deposited in a timely manner. One check reviewed was not deposited for 40 days from the time of receipt. Additionally, as of March 15, 2006, the BSU was retaining four checks totaling \$640 for an exam scheduled for the end of March 2006.

Criteria: SAM Section 8023 states that all checks, money orders, and warrants received for deposit will be restrictively endorsed for deposit as soon as possible after receipt, but no later than the end of the working day.

SAM Section 8032.1 states that accumulated receipts of any amount will not remain undeposited for more than 10 working days.

Recommendation: Restrictively endorse receipts no later than the end of the working day, and deposit all cash receipts in a timely fashion.

### **Cash Disbursements**

Effective internal control over the cash disbursement process is necessary to ensure that controls are adequate to safeguard cash and to prevent and timely detect any errors or irregularities. The following weaknesses in the Board's internal control over cash disbursements were identified.

#### **FINDING 7                      Improper Cash Disbursement Procedures**

Condition: The Board has not consistently cancelled checks that are outstanding beyond their period of negotiability. As of February 28, 2006, 11 of 18 outstanding checks were over a year old and had not been escheated to the State Treasurer's Office. Additionally, the Accounting Officer does not review check requests and supporting documents prior to signing checks.

Criteria: SAM Section 8042 states that office revolving fund and general cash checks have a one year period of negotiability. Agencies are to send a stop payment request to the State Treasurer's Office for all uncashed checks, timed to arrive at least one week prior to the end of the one-year period of negotiability.

SAM Section 8080 states that checks must be compared with authorizations and supporting documents prior to signing.

Recommendations: Ensure checks outstanding beyond their period of negotiability are promptly cancelled and escheated to the State Treasurer's Office.

Review check requests and supporting documentation prior to signing checks.

## **Purchasing**

Effective internal control over purchasing is necessary to ensure that the Board acquires only those goods and services that are authorized and necessary for effective operations. The following weaknesses in purchasing controls decrease the Board's ability to effectively acquire necessary goods and services.

### **FINDING 8                      Lack of Review of Open Purchase Orders and Related Encumbrances**

**Condition:**                      Thirty purchase orders dated between April 10, 2002 and December 2, 2005 totaling \$76,476 were still open. Additionally, 15 of the 30 purchase orders had open encumbrance balances totaling \$39,499 posted to the accounting records.

**Criteria:**                      SAM Section 8422.20 instructs agencies to develop procedures to review open purchase documents in order to determine whether all goods and services have been received.

**Recommendation:**        Establish procedures for review of open purchase orders and related encumbrances to ensure that goods and services ordered are received or if no longer required, the money is unencumbered.

### **FINDING 9                      Review Procedures Need Improvement**

**Condition:**                      Receiving reports are not complete. The reports contain a date stamp indicating the order is complete; however, the report does not contain the initials or signature of the receiver. Specifically, 7 of 17 (42 percent) receiving reports reviewed did not have the receiver's signature or initials.

Additionally, 5 of the 17 (30 percent) invoices tested did not have a signature approving the invoice for payment.

**Criteria:**                      SAM Section 8422.20 states receiving reports will be prepared only after carefully checking the quantity, description, and condition of the goods and will be signed by the person responsible for checking and taking custody of the goods.

SAM Section 8422.1 states that the first step in the claim procedure is the determination that invoices are proper for submission to the SCO for payment.

**Recommendations:**        Require that all receiving reports be signed or initialed by the receiver.

Ensure invoices include the approver's initials or signature and date to indicate the invoice has been reviewed and is authorized for payment.

## Revolving Fund

Effective internal control over the revolving fund is necessary to ensure that the fund has not exceeded the authorized amount, is reimbursed on a timely basis to prevent the fund from being overdrawn, is used for authorized purposes, and accountability is maintained. The following weaknesses in the Board's internal control over the revolving fund were identified.

### **FINDING 10                      The Board Lacks Adequate Controls Over Its Revolving Fund Processes**

- Condition:                      The revolving fund is not reimbursed timely to prevent overdrafts. During September, October, and December 2005, and January 2006, the revolving fund account was overdrawn between \$9,314 and \$140,906.
- Additionally, travel and salary advances are not cleared timely. As of February 28, 2006, nine travel advances totaling \$1,330 were outstanding over 90 days. Two of the nine travel advances dated back to 1986. Nine salary advances totaling \$11,230 were outstanding over 60 days. Six of the nine salary advances dated back to the 1980s.
- Criteria:                        SAM Section 8047 says that state agencies will make every effort to prevent overdrafts in their centralized State Treasury System accounts, both with respect to agency bank balances and SCO balances.
- SAM Section 8776.7 requires reimbursement to the state of overpayments made to employees. Employee overpayments can arise from Office Revolving Fund salary and travel advances and payroll warrants issued by the State Controller's Office.
- Recommendation:           Increase efforts to collect outstanding revolving fund receivables promptly and/or write-off uncollectible amounts.

### **FINDING 11                      No Submittal of the Report of Office Revolving Fund Deficiency Claims for Reimbursements**

- Condition:                      The Board did not submit its Report of Office Revolving Fund Deficiency Claims for Reimbursement to the Department of Finance for fiscal year 2004-05.
- Criteria:                        SAM Section 8072 states that for each fiscal year, agencies will prepare and submit a report of office revolving fund deficiency claims for reimbursements *whether or not such claims were filed*. If no claims were filed during the fiscal year, the report will contain the statement, "No Claims for Reimbursement were filed during the fiscal year." If claims were filed, the report will detail the disposition of all Claims for Reimbursement. The report will be submitted to the Department of Finance, Office of State Audits and Evaluations, by September 30.
- Recommendation:           Complete and submit the required report in accordance with state requirements.



## **Personnel and Payroll**

Effective internal control over the personnel and payroll functions is required to ensure that Board staff are properly appointed, staff are not separated with outstanding advances or in possession of Board assets, and payroll information is processed accurately and timely. The following weakness in the controls over personnel and payroll was noted.

### **FINDING 12                      Inadequate Control over Employee Separations**

Condition:                      The Board does not adequately complete exit clearance forms for separating employees. Of the ten separated employees selected for testing:

- Four employees did not have an exit form completed.
- One form reported as prepared could not be located.
- Two forms were incomplete.
- None of the presented forms received sign off from the personnel office.

If properly completed, these forms would provide the Board with a method for ensuring that outstanding advances are collected prior to separation, all state property assigned to the employee is returned, and access to data, facilities, and equipment is properly terminated.

Criteria:                      SAM Section 8580.4 states that salary warrants will not be distributed to terminating employees until the agency is assured that all outstanding travel and salary advances have been paid. This may be done by incorporating advance collections into a general "check-out" list, along with other acknowledgments for the return of state credit cards, keys, records, and equipment prior to the release of the final warrant.

Recommendation:                      Complete exit clearance forms for all separating employees and ensure that all outstanding advances are repaid, assigned equipment is returned, and access to assets is terminated.

## **Contracts**

Adequate internal control over contracting ensures that the Board's procurement is effective and complies with state laws and regulations. We identified the following weakness in the Board's internal control over contracting.

### **FINDING 13                      Contract File Documentation Could be Improved**

Condition:                      Contract files do not always include the required documentation. Specifically, contract managers are not maintaining an expenditure ledger to track invoice payments, to document contract balances, and to ensure that sufficient funds are available to pay for services rendered. Additionally, of the eight contract files selected for testing, four did not contain a complete copy of the contract. In most cases only a contract cover page was included.

Criteria: State Contracting Manual (SCM) Section 9.09 requires each agency to maintain all invoices, records, and relevant documentation for three years after final payment under the contract. This includes preparing a spreadsheet of expenditures.

SCM Section 9.04 states that the responsibilities of contract managers include maintaining contract documentation and monitoring contract expenditures.

Recommendation: Ensure that proper documentation is prepared and maintained.

## CONCLUSION

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Our review of the State Personnel Board's (Board) internal control presents opportunities for the Board's management to correct identified weaknesses and improve its operations. We believe internal control would be strengthened and the Board would operate more effectively if the Board implements our recommendations. The reportable conditions, if left uncorrected, increase the risk that material errors or irregularities could occur and remain undetected, and the material weakness, if left uncorrected, could adversely affect the Board's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements.

The findings in this report are based on fieldwork performed between March 2, 2006 and May 11, 2006. We presented these findings to the related divisions and units at the completion of each cycle and at the exit conference held on July 19, 2006.

## AGENCY RESPONSE

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## MEMORANDUM

DATE: October 6, 2006

TO: Diana L. Ducay, Chief  
Office of State Audits and Evaluation

FROM: State Personnel Board  
Executive Office

SUBJECT: Response to the State Personnel Board's Internal Control Review

We have reviewed the draft internal control review of the State Personnel Board and have no issues with the deficiencies identified by the audit team. We appreciate the efforts of the audit team and are committed to using the information contained in the draft report to make the process changes necessary to ensure the integrity of our internal control structure. Our staff has begun working on a comprehensive corrective action plan.

If you have any questions, please call Lori Gillihan, Assistant Chief, Administrative Services Division at (916) 653-1026.

Original signed by:

Floyd D. Shimomura  
Executive Officer

cc: L. Aguilera  
M. Fernandez  
L. Gillihan